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C O N F I D E N T I A L SECTION 01 OF 02 BAKU 000416

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SUBJECT: AZERBAIJAN: NABUCCO CONTINUES TO WORK FOR SHAH
DENIZ VOLUMES

Classified By: Ambassador Anne E. Derse, reasons 1.4 (b,d)

¶1. (C) SUMMARY: According to Nabucco Pipeline General Manager Reinhard Mitschek, the Nabucco Pipeline Consortium is increasingly focusing on the commercial mechanism the Shah Deniz consortium will devise to market its gas. To break the Turkish transit deadlock, it is contemplating offering Turkey the ability to off-take additional amounts from Nabucco in the case of a "security of supply event." Nabucco is seeking all available Shah Deniz volumes. Nabucco has been told by SOCAR that in the case of having to decide between TGI and Nabucco, SOCAR will choose Nabucco, although SOCAR hopes that with the addition of Turkmen gas, Nabucco and TGI would be possible. An inter-governmental agreement (IGA) among the Nabucco countries is expected to be signed in June, with Azerbaijan to be invited as an observer country. END SUMMARY.

¶2. (C) On April 23 Ambassador Derse met with Nabucco Gas Pipeline Managing Director Reinhard Mitschek and OMV Azerbaijan office director Wolfgang Sporrer. On April 28, Emboff again separately met with Sporrer, to get a readout of the April 24 Nabucco meetings with SOCAR and with the Shah Deniz Consortium.

¶3. (C) Mitschek said he was in town for separate meetings with both SOCAR and the Shah Deniz Consortium. Nabucco was increasingly following the issue of Shah Deniz Phase Two (SD2) gas marketing, i.e. the commercial entity or entities created by the Shah Deniz Consortium with whom Nabucco would have to reach agreement concerning SD2 sales. Mitschek had heard that there would be a special purpose vehicle (SPV), similar to the Azerbaijan Gas Supply Company's (AGSC - headed by Statoil) role in marketing Shah Deniz Phase One (SD1) gas, but it was unclear which companies would be part of such an SPV. He had also heard that the Shah Deniz Consortium had received a verbal commitment from the EU for joint marketing of SD2 gas in Europe, allowing the SD Consortium to sell into Europe without competition law problems. (COMMENT: SOCAR comments re SD2 marketing will be covered in upcoming septel).

¶4. (C) According to Mitschek, SD Consortium member StatoilHydro had told OMV that SD2 will have 13 billion cubic meters annually (bcm/a), available no earlier than late 2013. It is expected that once Azerbaijan, Georgia and Turkey have bought SD2 gas, no more than 7 to 8 bcm/a will be available for sales to Europe. (COMMENT: StatoilHydro has told Embassy that it expects at best approximately 6 to 9 bcm/a available for sales to Europe.) Mitschek said that SD2 can sanction "either TGI or Nabucco" but not both. For Nabucco to be

green-lighted, it needs all of the expected 7-8 bcm/a of SD2 - "if SD divides its sales, there is no Nabucco" - plus "soft commitments" from suppliers for volumes of up to 20-25 bcm/a by 2015-2016. (Sporrer later told Emboff that the official OMV line was that 12 bcm/a were needed to sanction, with a soft commitment for another 12 bcm/a. Sporrer said that from a technical viewpoint the easiest solution was to ship Turkmen gas across Iran to Turkey, and that such a solution would accord with all international laws, although he acknowledged Emboff's point that the USG would be strongly opposed to such a "solution.")

15. (C) Mitschek said that Nabucco looked to Azerbaijan, Turkmenistan, Iraq and Egypt to supply the volumes necessary to make Nabucco commercially viable. In this regard, Nabucco was quite heartened by EU External Relations Commissioner Ferrero-Waldner's early April visit To Turkmenistan and subsequent claim that she had gotten Turkmen agreement to supply 10 bcm/a to Nabucco.

16. (C) Mitschek said that the EC had told OMV that the July 2007 TGI IGA would be considered "null and void" because it violated EU competition law, although the EC has not yet informed the TGI Consortium members as such. The Turkish 15 percent netback scheme in this IGA was also contrary to EU law. According to Mitschek, the EC has told OMV that the Nabucco partners could initiate a process that would result in the EC declaring the TGI IGA null and void, but Mitschek said Nabucco will not do, so as it doesn't wish to irritate Turkey.

17. (C) Mitschek deprecated TGI, saying that its lack of third party access made it essentially an "(Italian energy company) Edison pipeline," i.e. a pipeline built to serve only Edison

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(and to a lesser extent the Greek energy company DEPA). It would not even deliver gas to northern Italy, where demand was highest, whereas a Nabucco pipeline could build a spur from Baumgarten, Vienna to service this market.

18. (C) To assuage Turkish supply concerns, Mitschek said that the Nabucco shippers were contemplating offering a "security of supply event" clause to Turkey. This clause, approved by both OMV and RWE so far, would allow Turkey to offtake as much as 40 percent of transiting gas at market prices if an independent organization certifies that there is a "security of supply event" in Turkey. The consumers whose gas was being off-taken by Turkey would get gas from OMV storage. (COMMENT: SOCAR envisions that the Turkish transit impasse will be solved by selling Turkey additional volumes in a separate sales and purchase agreement - upcoming septel).

19. (C) In order to satiate Turkish desire to be "more than a transit country," Mitschek said that the Nabucco consortium was also contemplating an OMV-Botas joint venture trading company in Turkey. Whereas large EU gas suppliers would buy directly from the gas producers, smaller buyers might buy from a non-single source "gas basket" offered by this GoT-OMV joint venture, to mitigate risk. Nabucco has not broached this idea, nor the "security of supply event" clause, to the GoT yet.

110. (C) Mitschek said that the final draft of a Nabucco countries IGA would be ready in June. The EU has already approved the draft in its current form. Nabucco will seek to sign such an IGA in June in the Hague, with Azerbaijan invited as an observer country.

NABUCCO SOCAR & SHAH DENIZ MEETINGS

111. (C) OMV Azerbaijan Country Representative Wolfgang Sporrer separately told us that in an April 24 meeting with SOCAR Vice-President for Marketing Elshad Nasirov, Nasirov said that Azerbaijan was seeking to provide gas to all the

major competing pipeline projects, assuming that with the addition of Turkmen gas, there would be enough gas for TGI, TAP and Nabucco. However, according to Sporrer, Nasirov also told them that if SOCAR had to choose between TGI and Nabucco, "it would choose Nabucco." (However, in a separate April 28 meeting with Emboff, Nasirov said he thought it unlikely that Turkmen gas could be brought into the Azerbaijani grid in time for a 2013 Nabucco, adding that he saw no reason why Nabucco couldn't be started later). According to Sporrer, Nasirov also said that Nabucco's meeting later that day with the Shah Deniz consortium was essentially pointless, since it would be SOCAR deciding where the SD2 gas went. Sporrer said that all SD Consortium members were present for Nabucco's Shah Deniz meeting, although consistent with Nasirov's statement, SOCAR had sent only a relatively junior employee. Sporrer described the SD Consortium meeting as a "beauty contest," where Nabucco made a presentation and fielded a few questions. Nabucco's own questions about the marketing of SD2 gas were not answered.

¶12. (C) COMMENT: The Nabucco Consortium continues to make steady progress in its bilateral negotiations with Azerbaijan, although it still has not found the minimal "missing volumes" needed to sanction the project.
DERSE